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No. 08-916

IN THE

Supreme Court of the United States

VFJ VENTURES, INC., F/K/A VF JEANSWEAR, INC.,

Petitioner,

v.

G. THOMAS SURTEES, IN HIS OFFICIAL CAPACITY AS COMMISSIONER OF THE DEPARTMENT OF REVENUE FOR THE STATE OF ALABAMA, AND THE ALABAMA DEPARTMENT OF REVENUE,

Respondents.

On Petition for Writ of Certiorari to the Supreme Court of Alabama

BRIEF OF INSTITUTE FOR PROFESSIONALS IN TAXATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D. C. 20002

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BRIEF OF INSTITUTE FOR PROFESSIONALS IN TAXATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

INTEREST OF THE *AMICUS CURIAE*

This brief *amicus curiae* in support of Petitioner, VFJ Ventures, Inc., f//k/a VF Jeanswear, Inc. ("VFJ"), is filed on behalf of the Institute for Professionals in Taxation ("IPT").[1] IPT is a non-

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[1]Pursuant to Sup. Ct. Rule 37.6, *amicus* Institute for

profit educational organization that seeks to promote uniform and equitable administration of state taxes. IPT has more than 4,500 members representing more than 1,400 businesses across the United States and in Canada. Represented within IPT's membership are numerous small businesses and most of the Fortune 500 companies spanning all major industries. IPT members represent some 387 corporations doing business in Alabama and states with add-back statutes that are similar to the Alabama statute at issue here.

SUMMARY OF ARGUMENT

Hundreds of America's major businesses have had their due process rights violated by Alabama, causing them significant harm for which they can never be fully compensated. Therefore, the Court should grant VFJ's *cert* petition now and put an end to the violation, so that the damage can be mitigated. The Alabama add-back statute challenged by VFJ denies due process to businesses because it determines a corporation's Alabama tax base by reference to a factor that has no rational relationship to the corporation's in-state values – the tax policies of other states.

The past eight years have seen a proliferation of similar add-back statutes around the country. Today, twenty other states and the District of

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Professionals in Taxation states that no counsel for a party has written this brief in whole or in part and that no person or entity, other than *amicus*, its members, or counsel, has made a monetary contribution to the preparation or submission of this brief. Both parties have consented to the submission of this brief in letters filed with the Clerk.

Columbia also have add-back statutes that suffer from constitutional defects, and more states have recently considered adoption of such measures. This accelerating trend toward state use of add-back statutes to tax extraterritorial values, in violation of corporate taxpayers' due process rights, must be stopped now.

The danger and the damage are not limited to the serious harm that is specific to America's businesses, for add-back statutes also undermine another national interest of preeminent importance: they authorize a state to tax income that is unquestionably attributable to other states. Such extraterritorial taxation has long been recognized by this Court to be a pernicious threat to the very foundation of our economic cohesion as one nation – the maintenance and protection of a single nationwide free-trade zone that the Commerce Clause has long been understood to guarantee. The writ should be granted.

REASONS WHY THE WRIT SHOULD BE GRANTED

I. IMPORTANT CONSTITUTIONAL QUESTIONS WILL GO UNRESOLVED UNLESS THE WRIT IS GRANTED

The apportionment question raised by VFJ's *cert* petition – how much income is attributable to and thus taxable by the state? – implicates both the Commerce Clause of the United States Constitution and the Due Process Clause of the Fourteenth Amendment.[2]

[2] U.S. Const. art. I, §8, cl. 3; U.S. Const. amend. XIV.

A. Alabama Has Undermined the Integrity of Our System of Interstate Commerce by Unfairly Apportioning Income

The Alabama add-back statute enlarges the portion of a taxpayer's income attributed to Alabama by the amount of a taxpayer's expenses for royalties and interest paid to an affiliate, except "to the extent ... that the corresponding item of [royalty and interest] income was .... subject to tax ... in Alabama or any other state."[3]

This statute, on its face, raises a fundamental issue of constitutional law: Can a state tax income not properly attributable to it, simply because no other state has chosen to tax it? More specifically, when only a certain portion of a company's income is concededly subject to tax by a state, does the United States Constitution permit that state to enlarge the share it taxes by an amount not properly attributable to it, simply by reason of the taxpayer's payments to an affiliate that is not taxed on the corresponding income elsewhere?

The add-back adjustment in question operates wholly without regard to the quantum or portion of VFJ's multistate business activities in Alabama; it was triggered by VFJ's payment of royalties to an out-of-state affiliate located in a jurisdiction that did not tax the affiliate's royalty income. Identical payments would have been deductible under the Alabama statute if made to an affiliate in Alabama or in another jurisdiction that taxes such royalty income on a separate return. The issue considered here thus is of the statute's facial invalidity under

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[3] Ala. Code §40-18-35(b)(1).

the fair apportionment requirement of the Commerce Clause, in particular whether that command tolerates an apportionment scheme which entirely disregards any taxpayer's business activities in Alabama and looks instead to the tax treatment of an affiliated entity's income in another jurisdiction.

1. The Commerce Clause Protects Our National Free-Trade Zone from Extraterritorial Taxation by States

A tax on multistate income must be nondiscriminatory and "properly apportioned to local activities within the taxing State . . . ."[4] The Court has linked the requirements for nondiscrimination and fair apportionment, observing that "[a] tax that unfairly apportions income from other states is a form of discrimination against interstate commerce."[5] It has said that those two dictates work together to "prohibit taxes that pass an unfair share of the tax burden onto interstate commerce."[6] Among the constitutional objectives served by the fair apportionment and nondiscrimination requirements as limitations on state taxing powers is that of maintaining an open economy.[7]

The Commerce Clause assures a national marketplace unfettered by state revenue measures that would interfere with transactions in interstate

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[4] *Northwestern States Portland Cement Co. v. Minnesota.*, 358 U.S. 450, 495 (1959).

[5] *Tyler Pipe Indus., Inc. v. Wash. State Dep't of Revenue*, 483 U.S. 232, 247 (1987).

[6] *Quill Corp. v. North Dakota.*, 504 U.S. 298, 313 (1992).

[7] *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 289 (1978) (Powell, J., dissenting); *see also, Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977).

commerce.[8] Exemplary of offending measures is the example Alexander Hamilton gave in *The Federalist No. 7* of New York laying duties on imports that would be paid by residents of Connecticut and New Jersey, as to which the author rhetorically asked: "Would Connecticut and New Jersey long submit to be taxed by New York for her exclusive benefit?"[9] Hamilton also argued in *The Federalist No. 11* for "an unrestrained intercourse between the States," pointing out that the alternative would be that commercial "intercourse [among the states] would be fettered, interrupted and narrowed by a multiplicity of causes," when what is needed instead is a "unity of commercial, as well as political interests."[10]

The Alabama add-back scheme is precisely one such sub-national political interference with the free flow of commercial transactions among the states. On its face, the statute arrogates taxable income to Alabama simply because other states have chosen not to tax it, and thus in practice the statute serves to interrupt interstate commerce by discouraging corporations subject to Alabama tax from doing business in states whose tax policies do not coincide with those of Alabama.[11] The statute has the kind of narrowing, or channeling effect, of which Mr.

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[8] *See Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318, 329 (1977).

[9] The Federalist No. 7, at 63 (Alexander Hamilton) (Clinton Rossiter ed., 1961).

[10] The Federalist No. 11, at 89-90 (Alexander Hamilton) (Clinton Rossiter ed., 1961).

[11] Alabama's attempt to clothe the statute with facial neutrality by foregoing the add-back adjustment for interstate transactions with some, but not other, states is unavailing. *See New Energy Co. of Ind. v. Limbach*, 486 U.S. 269, 274-75 (1988) and decisions cited there rejecting such alliances of reciprocity.

Hamilton wrote. Allowing such measures to stand would invite the spider-webbing of interstate commerce with a "multiplicity" of provincial causes, a result that is pernicious to our economic freedoms as a nation.

2. The Statute Is *Per Se* Invalid Because, on Its Face, Its Operation is Triggered by Out-of-State Events

It is unlawful for Alabama to tie Alabama tax liability to matters that occur solely in other states. A respected constitutional scholar has noted that the Court's precedents have established "a virtually *per se* rule of invalidity for extraterritorial state regulations," including "laws whose operation is triggered by out-of-state events."[12] The Alabama add-back statute, which triggers an increase in an in-state royalty payor's tax liability based upon an out-of-state event – taxation or non-taxation of the corresponding income recipient elsewhere – is just such a law. Consequently, the Alabama add-back statute is *per se* invalid under the Commerce Clause.

Furthermore, an expense disallowance law "whose operation is triggered by out-of-state events" abandons the necessary rational connection between the taxpayer's in-state activity and its tax base in that state. In response to an earlier contention that the Michigan single business tax failed the "external consistency" test under the Commerce Clause,[13] the

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[12] Laurence H. Tribe, AMERICAN CONSTITUTIONAL LAW, § 7-8 at 1064, (3d. ed.) 2000.

[13] In *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 169 (1983), the Court held that fair apportionment demands external consistency: apportionment must "actually

Court framed the inquiry as whether "there is no rational relationship between the tax base measure attributed to the State and the contribution of Michigan business activity."[14] Fair apportionment demands the presence of such a rational relationship. A statute attributing income to a taxing jurisdiction when there is no reasonable connection between that income and the in-state business activities of the taxpayer is irrational, and therefore necessarily fails to "fairly apportion" income to that state.

While some arrangements may need proof that the statute works an irrational and therefore unfair result, others may be judged irrational on their face.[15] In *Hunt-Wesson,*[16] the Court struck as invalid on its face a California statute disallowing a deduction for interest expense in an amount equal to "certain out-of-state income ... that the state could not otherwise tax."[17] The Court did not require proof of the statute's impact in practical application, for the statute failed on its face to "actually reflect a reasonable sense of how income is generated" – the dictate of the external consistency test.[18]

The same may be said of the Alabama add-back statute. On its face, the statute determines the deductibility of a taxpayer's royalty expenses on

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reflect a reasonable sense of how income is generated." *Id.*

[14] *Trinova Corp. v. Mich. Dep't of Treasury*, 498 U.S. 358, 380 (1991).

[15] *See Norfolk & W. Ry. Co. v Mo. State Tax Comm'n*, 390 U.S. 317, 325 (1968) ("Any formula used must bear a rational relationship, both on its face and in its application, to property values connected with the taxing State").

[16] *Hunt-Wesson, Inc. v. Franchise Tax Bd.*, 528 U.S. 458 (2000).

[17] *Id.*, at 460.

[18] *Id.*, at 466 (quoting *Container Corp.*, 463 U.S. at 169.)

whether the corresponding royalty income is taxed elsewhere. This determinative factor does not "actually reflect a sense of how [the] income is generated,"[19] so the Alabama add-back statute is unconstitutional on its face.

It may be worth mentioning here another way in which the statute is irrational and facially distortive: The statute adds back the royalty payments as "income" to VFJ without any offset for the expenses of generating that income. Were Alabama to tax the income in the hands of the parties that earned it (Lee and Wrangler), that tax base amount would be reduced by those corporations' expenses. Moreover, the amount of their income subject to tax in Alabama would be calculated by reference to Lee's and Wrangler's apportionment factors, not VFJ's. The Court has not ruled but recently commented upon the possible constitutional dimensions of such a disconnect.[20]

3. The Statute Invalidly Aims to Tax Income Attributable to Other States

The Commerce Clause "external consistency" test articulated in *Container*[21] was later explained by the Court to encompass more than the rationality concern addressed above. In *Jefferson Lines*, the Court described this additional concern as follows:

> External consistency . . . looks . . . to the economic justification for the State's claim

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[19] *Id.*

[20] *See MeadWestvaco Corp. v. Ill. Dep't of Revenue*, 128 S.Ct. 1498, 1509, n.4 (2008).

[21] *Container Corp.*, 463 U.S. at 169.

upon the value taxed, to discover whether a State's tax reaches beyond that portion of value that is fairly attributable to activity within the taxing State.[22]

A common economic justification for add-back statutes is that they enable the state to tax certain items of income that go untaxed by any state – amounts that have been pejoratively characterized in this and other contexts as "nowhere income."[23] Such legislative justifications are invalid, for the targeted income is in fact "somewhere," even when the jurisdictions to which these amounts are properly attributable are simply not taxing it for tax policy or other reasons. A decision by one state not to tax is no justification for another state to enlarge its tax base by the amount of the non-taxing jurisdiction's attributable portion of the company's multistate income.

The Alabama statute is an aggravated transgression of the constitutional fair apportionment requirement for the reason that its very object is to enlarge the Alabama tax base beyond the income that is properly attributed to

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[22] *Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 185 (1995).

[23] *See, e.g., Geoffrey Inc. v. S.C. Tax Comm'n.*, 437 S.E.2d 13, 17, n. 1 (S.C. 1993) ("The net effect of this corporate structure [payment of royalties to an out-of-state affiliate] has been the production of 'nowhere' income . . ."). *See also, American Tel. & Tel. Co. v. Wisc. Dept. of Rev.*, 422 N.W.2d 629, 635 n. 16 (Wisc. Ct. App. 1987); *Lanco, Inc. v. Dir., Div. of Taxation*, 21 N.J. Tax 200 (N.J. Tax Ct. 2003), *rev'd*, 879 A.2d 1234 (N.J. Super. App. Div. 2005), *aff'd*, 908 A.2d 176 (N.J. 2006); *Caterpillar Tractor Co. v. Dept. of Rev.*, 8 Or. Tax 236 (Or. T.C. 1979); Virginia Pub. Doc. Rul. No. 91-258 (10/28/1991).

Alabama. Lee and Wrangler are headquartered in Delaware and have their offices and all their employees there.[24] From that location they do business, not just with VFJ but with unrelated third parties as well.[25] VFJ's payment of royalties to Lee and Wrangler were determined by the lower courts to be ordinary and necessary expenses of doing business,[26] and the corresponding royalty income was received by Lee and Wrangler.

If the State of Alabama were taxing Lee and Wrangler directly (it is not), Alabama would attribute none of this royalty income to Alabama because the State, through its adoption of the Multistate Tax Compact,[27] attributes receipts from the sale of intangibles to the state where the greater proportion of income-producing activity occurs – Delaware, for Lee and Wrangler.[28] Thus, for apportionment formula purposes, Alabama recognizes that the receipts from the royalty transactions here are properly identifiable with Delaware, not Alabama.

The Alabama add-back statute, however, reflects the legislature's discontent with these normal rules for attributing such royalty income to affiliates over which the State does not (or cannot)

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[24] *See VFJ Ventures, Inc. v. Surtees*, No. CV-03-3172 (Cir. Ct. Montgomery County, Ala. Jan. 24, 2007); App. to Pet. Cert. 69a.

[25] *Id.*

[26] *See Surtees v. VFJ Ventures, Inc.*, No. 2060478, 2008 WL 344118, at *11 (Ala. Civ. App. Feb. 8, 2008); App. to Pet. Cert. at 28a.

[27] *See* §17 of the Multistate Tax Compact, available at http://www.mtc.gov.

[28] *See* Ala. Code §40-27-1; *see also* §17 of the Multistate Tax Compact.

assert taxing jurisdiction. In such a case, the add-back statute disregards the usual attribution of the receipts to Delaware. Sensing a revenue opportunity created by Delaware's tax policy (exemption of this type of royalty income from Delaware taxation), Alabama uses the add-back statute to shift that Delaware income into the Alabama tax base.

In this very real sense, then, the Alabama statute is intentionally distortive. Rather than making an effort to "reasonably" reflect the geographic location where the subject income is earned, it does precisely the opposite. It purposefully eschews that attribution – solely because the jurisdiction with which the income is rationally identifiable has chosen not to tax it. The very object, the only object, of the add-back is income fairly attributable to a jurisdiction other than Alabama. If that other jurisdiction elects to tax the income, the add-back statute stands idle; if that other jurisdiction elects not to tax the income, the add-back statute inflates the taxpayer's Alabama tax base. As one eminent scholar has observed of such practices, however, "States do not acquire the power to tax income earned elsewhere merely because the income is not taxable where it is earned."[29] The intentional character of this distortion of income is plain on the statute's face.

As a measure which forsakes any effort to attribute income based on a rational view of where the income is earned, the Alabama add-back statute

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[29] 1 Jerome R. Hellerstein & Walter Hellerstein, STATE TAXATION, ¶ 10.03[5], at 10-33 (3d. ed. 2000) (discussing *Luckenbach S.S. Co. v. Franchise Tax Bd.*, 33 Cal. Rptr. 544 (Cal. Ct. App. 1963), *appeal dismissed*, 377 U.S. 215 (1964)).

falls short on its face of the constitutional demand for fair apportionment. It reveals patent overreaching of the taxing jurisdiction's boundaries simply because another jurisdiction has chosen not to tax. The Court should grant the Petition for Certiorari in order to safeguard the guarantee of fair apportionment that income attribution be based on a rational effort to relate the income to the taxpayer's business activities in the taxing state.

B. Alabama Has Denied Due Process of Law to VFJ and Other Corporations

Hundreds of major corporations and perhaps thousands of smaller ones, including businesses represented in IPT's membership, are currently being deprived of their due process rights by the State of Alabama and twenty-one other jurisdictions that have adopted similar add-back statutes.[30] Even though a split of state high court authority has not yet developed on the issues presented here, the Court should grant the writ now because these due process violations are serious, widespread, and accelerating.

1. Due Process Protects Corporate Persons from State Taxation of Values Not Rationally Related to that State

The Due Process Clause of the Fourteenth Amendment to the United States Constitution provides: "nor shall any State deprive any person of life, liberty, or property, without due process of law."[31] The Constitution guarantees due process to

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[30] See statutes cited *infra* n. 43.

[31] U.S. Const. amend. XIV, §1

corporate persons as well as natural persons,[32] aiming in both contexts to ensure the maintenance of "traditional notions of fair play and substantial justice."[33] Taxation, of course, deprives a corporate person of its property, so the question with which this case is centrally concerned – how much of a corporate person's income is properly attributable to (and thus taxable by) a particular state – is a question with significant due process implications. The Court, while recognizing "the difficulty of identifying the geographic source of the income earned by a multistate enterprise,"[34] has repeatedly applied the following due process principle to such questions: "[T]he income attributed to the State for tax purposes must be rationally related to 'values connected with the taxing State."[35] In a slightly different formulation, the Court has explained that a taxing scheme violates due process rights if there does not exist "a rational relationship between the income attributed to the State and the intrastate values of the enterprise."[36]

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[32] *See e.g., First Nat'l Bank v. Bellotti*, 435 U.S. 765, 780 (1978) (citing, *Santa Clara County v. Southern Pacific R.R. Co.*, 118 U.S. 394 (1886); *Covington & Lexington Tpk Rd. Co. v. Sandford*, 164 U.S. 578 (1896)).

[33] *Quill*, 504 U.S. at 307 (citation omitted).

[34] *Trinova Corp. v. Mich. Dep't. of Treasury*, 498 U.S. 358, 373 (1991).

[35] *Moorman Mfg. Co.*, 437 U.S. at 273 (1978) (quoting *Norfolk & Western Ry. Co.*, 390 U.S. at 325 (1968); *see also*, *Mobil Oil Corp. v. Comm'r of Taxes of Vt.*, 445 U.S. 425, 437 (1980).

[36] *Exxon Corp. v. Wis. Dep't. of Revenue*, 447 U.S. 207, 219-20 (1980) (quoting *Mobil Oil Corp.*, 445 U.S. at 437).

2. The Statute Constitutes a Facial Denial of Due Process Because It Is Qualitatively Irrational to Determine Any Corporation's In-State Values Based on Another State's Tax Policies

State tax statutes may attribute to a corporate taxpayer's in-state tax-base only those amounts that are rationally related to the taxing state. One of the most fundamental ways that state tax statutes aim to achieve this rational attribution is by allowing deductions for amounts paid to others.[37] Alabama, like most states, starts out on the right path by taking as its starting point for the tax-base calculation the corporation's federal taxable income, a sum which already has such deductions netted out.[38]

Alabama does not stop there, however. With its add-back statute, the State proceeds to impose a critical limitation: An Alabama corporate taxpayer's deduction for certain expenses is allowed (that is, those amounts are removed from the corporation's Alabama tax base) only "to the extent" of the taxability by other states of the corresponding income in the hands of the recipient. To be precise, the statute bases the add-back determination (disallowance of the deduction) on whether the

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[37] Two corollary approaches, nearly universally applied by the states in conjunction with the deduction approach, are formulary apportionment, and division of the tax base between apportionable ("business") income/expense and allocable ("nonbusiness") income/expense. These tools all must comply with the due process requirement that the state apply its tax only to a corporation's values that are rationally connected to that state.

[38] Ala. Code § 40-18-33.

related-party payment-recipient is "subject to tax" somewhere – and then only if the taxing states have adopted tax regimes that, like Alabama's, require separate legal entities to file separate tax returns rather than taxing an entire unitary group of related corporations on a combined basis.[39] Thus, taxpayers may be entitled to exemption from the add-back to the extent the recipient of the income is taxed in certain states, but not if the recipient is taxed in others. That is, the Alabama add-back statute attributes income to the Alabama tax base of a corporation based upon the tax policy of other states.

Put another way, Alabama's add-back scheme irrationally posits a non-existent linkage between (I) another state's failure to tax an affiliated recipient's income and (II) the measure of the payor's income that is properly attributable to Alabama. By its very design, the add-back statute turns on an entirely extraneous factor – the recipient state's tax policies. This factor neither measures, nor bears any rational relationship to, the extent of the payor's business activities in the taxing jurisdiction – the central concern of due process analysis in this context.

In order to appreciate the true irrationality of the Alabama add-back statute, one might consider a hypothetical "blue eyed officer" add-back statute. Imagine a state statute that denies deductions for interest and royalties paid to related-party corporations – but only to the extent that the officers of the recipient corporation have blue eyes. (No deduction is allowed if all the officers have blue eyes, 75% of the deduction is added back if three-quarters have blue eyes, etc.) This is the kind of

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[39] Ala. Code § 40-18-35(b)(1).

irrationality that IPT's membership faces, indeed what all affected businesses face, when confronted with the Alabama add-back statute and the other strikingly similar add-back statutes in other states. When related-party expense deduction denials are based on the tax policy of other states, they may as well be denied based on officer eye color, for neither standard is rationally related to corporate values connected with the taxing state.

It may be noted that the appeals court decision in *VFJ Ventures*, adopted in its entirety by the Alabama Supreme Court, limits its due process discussion to what one might call the "quantitative irrationality" analysis in the *Hans Rees*[40] decision of this Court.[41] This quantitative irrationality analysis looks at numbers or percentages – comparing the apportioned tax base produced by the challenged statutory scheme to a hypothetically "correct" tax base, and asks whether the statutory result is "out of all appropriate proportion to the business transacted" by the taxpayer in the taxing state.[42] The "blue-eyed officer add-back" hypothetical demonstrates that the due process "rational relationship" requirement must necessarily have not only a quantitative aspect but a qualitative aspect as well. As demonstrated above, the Alabama add-back statute utterly fails qualitative irrationality analysis.

VFJ's *cert* petition asks the Court to review this case so the Court can tell America's businesses whether Alabama's add-back statute – which makes

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[40] *Hans Rees' Sons, Inc. v. North Carolina*, 283 U.S. 123, 134 (1931).

[41] *Surtees v. VFJ Ventures, Inc.*, 2008 WL at *25; App. to Pet. Cert. at 58a.

[42] *Hans Rees' Sons, Inc.*, 283 U.S. at 135.

the tax policy of other states the touch-stone for determining whether a corporation's Alabama tax base should be enlarged – satisfies the "rational relationship" test of *Norfolk, Moorman, Mobil Oil, Exxon,* and other decisions. The Court should grant the writ sought by VFJ in this case in order to bring a prompt halt to the actions of Alabama and many other states, which are trampling without compunction on the due process rights of business taxpayers across America.

II. THE NEED FOR REVIEW IS URGENT

A. The Proliferation of Similar Statutes Around the Country, and Continuing Uncertainty Regarding Their Validity, Impose Onerous Compliance Costs on America's Businesses

This Court should grant review because the same facial constitutional defects inhere in numerous similar state laws. If this Court declines to answer the question now, the effect on the nation's economy will be serious. The issue presented in this appeal is more than academic. It has severe practical implications for any corporation doing business in more than one state. There are two reasons for this.

First, add-back statutes are rapidly proliferating. Twenty of the twenty-two add-back statutes were enacted within the last eight years.[43]

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[43] Twenty-one states and the District of Columbia now have add-back statutes. All were enacted during or after 2001, except for Connecticut's add-back (enacted in 1998) and Ohio's add-back (enacted in 1991). See, Alabama (Ala. Code § 40-18-35(b)); Arkansas (Ark. Code Ann. § 26-51-423(g)); Connecticut (Conn. Gen. Stat. § 12-218c); District of Columbia (D.C. Code

Several other states have recently considered such statutes.[44] The trend is not surprising. States have been attempting to export their tax burdens since as far back as the 1780's, when the Constitution was adopted.[45] But the concern for the national economy

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Ann. § 47-1803.03(a)(19)); Georgia (Ga. Code Ann. § 48-7-28.3(b)); Illinois (35 Ill. Comp. Stat. 5/203(b)(E-12), (E-13)); Indiana (Ind. Code Ann. §§ 6-3-1-3.5(b)(9), 6-3-2-20); Kentucky (Ky. Rev. Stat. Ann. § 141.205); Maryland (Md. Code Ann., Tax-Gen. § 10-306.1); Massachusetts (Mass. Gen. Laws Ann. ch. 63, §§ 31I, 31J); Michigan (Mich. Comp. Laws § 208.1201(2)(f)); Mississippi (Miss. Code Ann. § 27-7-17(2)); New Jersey (N.J. Stat. Ann. §§ 54:10A-4; 54:10A-4.4); New York (N.Y. Tax Law § 208.9(o)); North Carolina (N.C. Gen. Stat. §105-130.7A); Ohio (Ohio Rev. Code Ann. § 5733.042); Oregon (Or. Admin. R. 150-314.295); Rhode Island (R.I. Gen. Laws § 44-11-11(f)); South Carolina (S.C. Code Ann. § 12-6-1130); Tennessee (Tenn. Code Ann. §§ 67-4-2006(b)(1)(K); 67-4-2006(d)); Virginia (Va. Code Ann. §58.1-402(B)); Wisconsin (Wis. Stat. §§ 71.26(2)(a), 71.80(23)).

[44] Pennsylvania and Minnesota each introduced legislation in 2005. See H.B. 518, 2005 Gen. Assem., Reg. Sess. (Pa. 2005); H.B. 660, S.F. 753, 2005 Leg., 84th Sess. (Minn. 2005). Anecdotal reports indicate that Texas, Iowa, Missouri, and West Virginia have also considered implementing add-back statutes. *See e.g.*, Michael S. Schadewald, *Deducting Related-Party Interest and Intangible Expenses* (2005), http://www.aicpa.org/pubs/taxadv/online/may2005/schadewald .htm; Joe Garrett and Kelly W. Smith, *Add-Back Statutes: Where Do We Go From Here?*, Presentation at 2005 SEATA Conference (July 12, 2005), http://www.seatastates.org/am_2005/garrett.pdf); E. Kendrick Smith and Matt Cristy, *Georgia Gets A Grasp On Passive Investment Companies: New Addback Statute Reaches Intangible And Interest Income Flowing From The State* (2005), http://www.jonesday.com/files/Publication/79016b8a-09fb-4dcc-b235-5a9c21fa29a9/Presentation/PublicationAttachment/4a6d1845-d6ca-4a03-88d25c97dc36a702/Dec2005_Smith_Cristy.pdf.

[45] *See e.g.*, Brannon P. Denning, *Confederation-Era Discrimination Against Interstate Commerce and the Legitimacy*

constrains what might be considered good local politics, and it is the responsibility of the courts to "more consistently and coherently bar [unconstitutional] tax exportation."[46]

Second, these statutes are particularly insidious because their effectiveness is directly linked to similar efforts by other states to export their tax burdens. That is, these statutes necessarily piggyback on other states' policy choices. They impact, and are impacted by, the tax laws of any other state in which a company does business. As a result, each change in *any* state tax law has the potential not only to alter a taxpayer's responsibilities in the state where the change occurred, but also to create a domino effect, upending the tax responsibilities for a single corporation in multiple states across the nation.

The burdens of complying with this Rubik's Cube of state laws are substantial. According to statistics from the Internal Revenue Service, businesses spent over three trillion hours to comply with the federal tax system in 2005. Small businesses accounted for over one trillion of those hours.[47] Compliance with the state tax systems of

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of the Dormant Commerce Clause Doctrine, 94 KY. L.J. 37, 53 (2005/2006) (noting that states' unwillingness to cede control over the levying of imposts and duties during that era was "due to the fact that such measures were a way to raise revenue without directly taxing their citizens.").

[46] *See, e.g.*, Daniel Shaviro, *An Economic and Political Look at Federalism in Taxation*, 90 MICH. L. REV. 895, 897 (1992).

[47] *See* J. Scott Moody, Wendy Warcholik, & Scott A. Hodge, *The Rising Cost of Complying with the Federal Income Tax*, Tax Foundation Special Report No. 138, 1, 8 (Table 5) (Dec. 2005).

the fifty states is significantly more burdensome, especially where, as here, states attempt to capture revenue based solely on another state's decision not to claim it.[48] To the extent that a company's tax liability is altered, the "piggybacking" of add-back statutes requires a company to review and analyze the procedural requirements for reporting such change in all relevant jurisdictions, recompute the liability, and issue the documentation necessary to meet those varying requirements. Further, the company may have to pay additional tax to several jurisdictions. The piggy-backing effect of the interaction between state add-back statutes and tax changes in other states makes it nearly impossible for companies to anticipate, even approximately, their state tax liability for a given period.

If the add-back statutes are permitted to stand, businesses will continue to be subject to the hefty compliance costs of a shifting, interdependent system of state tax laws, as well as the penalties and interest assessments associated with any inadvertent errors. The only way for corporations to avoid these burdens would be to restructure their entire organizations – and to review their structure again and again each time one state's change in the taxation of royalties or interest caused a domino effect across the nation – in an effort to accommodate these unconstitutional laws. Such restructuring itself comes with substantial costs. Not only must corporations pay for the planning and

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[48] *See* Sanjay Gupta and Lillian Mills, *Does Disconformity in State Corporate Income Tax Systems Affect Compliance Cost Burdens?*, NATIONAL TAX JOURNAL 56:2, 355 (June 2003) (indicating that state tax compliance costs are roughly double federal tax compliance costs).

implementation of these corporate changes, but they would also necessarily lose multiple benefits and efficiencies inherent in the corporate structure they have lawfully chosen.[49]

In non-recessionary times, these lost efficiencies and restructuring costs would be onerous. In the midst of faltering sales activity, declining profits, business closures, layoffs and bankruptcies, however, the effect is exacerbated. These burdens would be particularly damaging to small business. A decision from this Court could prevent states from continuing to enforce these unconstitutional laws and further weakening the nation's economy in this way.

B. America's Businesses Will Never Be Made Whole, But Prompt Resolution Will Mitigate the Damages

The issue addressed by this appeal is particularly time-sensitive. Failure to resolve it now will subject businesses to irreparable harm. Until this Court declares the Alabama add-back statute invalid, companies will continue to be compelled to pay unconstitutional taxes that they may never recover. Almost twenty years after this Court required states to provide "meaningful backward looking relief" for taxpayers subjected to unconstitutional taxes, "taxpayers remain unsure

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[49] As the trial court recognized below, VFJ's organizational structure has significant non-tax benefits, such as improving quality control and oversight of infringement defense, thereby protecting the value of the property, fostering detailed profit analysis, insulating the property from certain liabilities, preventing hostile takeovers, increasing liquidity, and creating economies of scale. *See Surtees v. VFJ Ventures, Inc.*, 2008 WL at *6; App. to Pet. Cert. at 17a.

about the remedies they can expect" once such statutes have been declared unconstitutional.[50] In fact, "States continue to attempt to avoid paying full refunds to taxpayers...."[51]

Alabama, in particular, has a history of delaying or refusing refunds to taxpayers who remitted tax pursuant to statutes later deemed to be unconstitutional. As recently as September, 2008, the Alabama Supreme Court applied a standard articulated by the lower court for allowing a state to "refus[e] to give a remedy" for tax paid under an unconstitutional statute when "*the state relied on now overturned precedent and the state now faces an extreme hardship if it must give a remedy.*"[52] Although it is unclear what constitutes "extreme hardship," this option could permit a state to refuse refunds to those taxpayers who paid large sums to the Department, or to refuse refunds in the event that numerous taxpayers had remitted the

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[50] Andres Vallejo and Scott M. Reiber, *Predicting the Remedy for Unconstitutional State Taxes: A Review of Recent Decisions Under the McKesson Framework*, TAX MANAGEMENT MULTISTATE TAX REPORT, Vol. 16, No. 1 at 9 (*citing McKesson Corp. v. Division of Alcoholic Beverages & Tobacco*, 496 U.S. 18 (1990)).

[51] *Id. See also*, Press Release, California Controller John Chiang, *Chiang Announces Payment Delays to Manage Cash Crisis* (January 16, 2009) (announcing blanket delays for tax refunds to business and individuals due to state cash flow problems).

[52] *Ex parte Surtees (Vulcan Lands, Inc. v. Surtees)*, Nos. 1070386, 1070399, 2008 WL 4369259, at *3 (Ala. Sept. 26, 2008), (*citing Vulcan Lands, Inc. v. Surtees*, No. 2060607, 2007 WL 4215046, at *7 (Ala. Civ. App., Nov. 30, 2007)). The Court ultimately held that the Department did not meet the standard, having failed to show that it relied on now overturned precedent.

unconstitutional tax. At the very least, the Alabama decision reflects an intent to deny some refunds of taxes unlawfully collected. The refunds at issue in the *Vulcan Lands* case involve payments of Alabama's foreign franchise tax, which this Court held to be unconstitutional *ten years ago*.[53]

CONCLUSION

Amicus respectfully submits that there is an urgent need for the Court to grant the writ in this case and move promptly to strike down Alabama's add-back statute which, like the twenty-one similar statutes across the country, denies America's businesses due process of law and undermines the integrity of the national free-trade zone that the Commerce Clause protects. Any delay will make it likely that affected businesses will never be adequately recompensed for their damages, and will also encourage more states to adopt add-back statutes that will continue to impair the free flow of commerce among them. The Court must make it clear to the states that such laws are impermissible. A failure to act will allow not just the continuation of irrational and overreaching taxation, but a continuing escalation of such measures by states anxious to reach values and income beyond their borders.

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[53] *South Cent. Bell Tel. Co. v. Ala.*, 526 U.S. 160 (1999).

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February 20, 2009